SOME PUBLIC ASPECTS OF THE ALDRICH PLAN OF BANKING REFORM[1]

To the advocates of a thoroughgoing reform of our banking system, perhaps the most encouraging feature of the eleven months' public discussion of the Aldrich plan is the practical unanimity shown by the banking community in its support—a unanimity which stands out in striking contrast to the attitude of bankers toward previous plans of banking reform. Less encouraging, however, is the comparatively indifferent attitude toward the proposed plan so far exhibited by the general public—an indifference which is surprising when one considers the far-reaching economic and social consequences of the proposed reform. One reason for this contrast between the attitude of the banking community and that of the general public is the fact that the Aldrich plan has so far been discussed principally as a banking proposition, in terms more or less technical to the general public. The commonest brief characterization of the proposed National Reserve Association is that of "a bankers' bank." Through the mechanism of a centralized reserve, bank acceptances, rediscounts, and an asset currency, the public is told, the banking business of the country is to be brought under a more unified control, reserve money is to be rendered mobile, and bank credit elastic. But these terms are not widely understood, and the organization through which such beneficent results are to be accomplished is so complicated that few bankers even can describe it offhand. For an understanding of the plan a greater amount of study and effort is necessary than most people are willing to give. Soon the proposal will come before Congress, and it is highly important that the public interest shall be aroused and that the broad features of the plan at least shall become familiar to all.

It is concerning some of the broad social aspects of the Aldrich plan in which the general public should be interested that I wish to speak today; for nothing deserves greater emphasis at this

[1] A paper read before the Western Economic Society, November 11, 1911.

time than the fact that the National Reserve Association, if established, will be a great public institution. It will, I believe, greatly improve our banking system as a banking machine, but it will be much more than a bankers' bank: it will vitally affect the welfare of over ninety millions of people.

First.—It is to be the depositary of government funds and through it the disbursements of the federal government are to be made. This means the virtual discontinuance of the independent treasury system which we have had for two generations, and the intrusting to the Reserve Association of the continual custody of from one hundred million to three hundred million dollars of public money; it means further that the association will annually disburse for the federal government two-thirds of a billion dollars and upward.

This feature of the Aldrich plan making the National Reserve Association the depositary of government funds is one of its great merits, because: (1) It will stop the continual hoarding in treasury vaults of sums ranging from twenty-five million to one hundred million dollars, involving socially an annual loss of from something like one to three million dollars interest, not to estimate the administrative expense. (2) It will free the money market from the disturbances which so frequently arise from wide variations in the net receipts or disbursements of the independent treasury. (3) It will relieve the secretary of the treasury of the onerous task of apportioning government balances, on the one hand between the independent treasury and the banks, and on the other hand among the depositary banks themselves—a task which under our present system places a very great power and responsibility over the money market in the hands of an appointive government officer. (4) It will require banks which need funds in times of pressure to seek them, not, as in the past, in the form of government deposits from the secretary of the treasury, but in the form of rediscounts or loans from the National Reserve Association. The officers of this association will be in a position to know the merits of individual applications for advances, and to adjust the discount rate to the demands of the market, and finally will be much freer from political pressure and criticism in such matters than is an administrative officer like the secretary of the treasury. The custody and payment of public funds will be effected in a

business way, and the secretary of the treasury will no longer be called upon to play the part of a kindly grandfather to a sometimes wayward money market.

Second.—A second privilege of the National Reserve Association which will be of wide public importance is its authority to fix from time to time an official rate of discount similar to the bank rates of European countries. Of course the association will be subject to decided limitations in fixing "the American bank rate"; it will not possess the dispensing power over the law of supply and demand, and if its rate is to be effective it must be fixed in sympathy with the fundamental conditions of the market. On the other hand, the powers of the National Reserve Association will be such that alterations in the official rate of discount, especially in times of pressure, will exercise a very real influence upon the market rate of interest. The fixing of the rate of discount is a necessary part of the Reserve Association's mechanism for centralizing banking power, and for mobilizing and rendering elastic bank credit. Furthermore, if one may judge from the experiences of such institutions as the Bank of England, the Bank of France, and the Reichsbank, the raising or lowering of the bank rate will be the most effective method available for curbing the money market. Normally an increase in the rate will be a warning to conserve credit, and, maybe, a signal of threatened storm; a decrease in the rate will be a notice that credit may be further extended, and that the storm is clearing away. One great public function of the National Reserve Association will be that of a conserver of bank credit, and in the work of credit conservation the fixing of the rate of discount will be the most effective tool.

Credit conservation will not only be *timewise*, preventing undue expansion in prosperous times, and undue contraction in times of danger; but it will also be *placewise*, tending to curtail bank credit in those sections where it is relatively redundant and to extend it in those sections where it is relatively scarce. To foreigners one of the most striking features of our American financial markets is the wide difference in interest rates which prevail in different parts of the country. The facts that the National Reserve Association's discount rate must be uniform throughout the United States, and that the association can make advances only on high-grade com-

mercial and bank paper, are likely to mean that in normal times the bank rate will be more effective in the West and South than in the East, and that the advances of the Reserve Association, like those of the First and Second United States banks, will be largest in the West and South, the sections of the country in which interest rates are normally highest. In the course of time as the funds of the association increase, and as the branches become more numerous and active, the wide differences in interest rates now prevailing in different sections of the country will tend to be broken down as they have been broken down in Canada.

In still other respects the power of the National Reserve Association over the discount rate will be of great public importance. Interest is a question of time value, that is, of the difference between the present value of a good at one time and the present value of the same good at another time. Directly and through the principle of capitalization interest is as all pervasive in the economic world as is time itself. Now the power to influence in any appreciable degree the rate of interest in the short-time money market is a power to influence the rate of interest at which borrowers throughout the country borrow money, a power to influence prices of produce and securities, a power to influence rates of foreign exchange and therefore the profits to be realized in foreign trade; it is even a power to influence public credit by affecting the prices of government securities. This power is subject to decided limitations, but is none the less real, as the experiences of European countries have proven, and although the percentages in which the values of these things will be influenced normally will be small, the bases upon which these percentages are calculated are very large. At times, moreover, the influence, upon values, of variations in the official rate of discount is very great even when measured in terms of percentage.

Third.—A third power of the proposed National Reserve Association which is of great public importance is the association's direct power over the foreign exchanges. It may deal in gold coin and bullion both at home and abroad; subject to certain restrictions it may "purchase from its subscribers and . . . . sell with or without its indorsement, checks or bills of exchange payable in England, France, or Germany, and in such other foreign countries as the board of the National Reserve Association may decide"; it

may "open and maintain banking accounts in foreign countries" and may "establish agencies in foreign countries for the purpose of purchasing and selling and collecting foreign bills of exchange." It shall have authority "to buy and sell . . . . through such . . . . agencies, checks or prime foreign bills of exchange which have arisen out of commercial transactions, which have not exceeding 90 days to run, and which bear the signatures of two or more responsible parties."

These powers are necessary for the National Reserve Association if it is to accomplish the main purposes of its creation. They give the association a safe and profitable field in which to invest surplus funds, and afford it effective means for controlling the money market in time of emergency. Through the extensive purchase or sale of foreign exchange, the purchase or sale abroad of the securities of foreign governments, and the importation or exportation of gold, the National Reserve Association could exercise a very great power, if need be, over the money market not only of the United States but also of Europe.

Through these powers, together with those of rediscount, the Reserve Association will certainly tend to delocalize American commercial paper, and to internationalize the American money market—services of the utmost importance both from the standpoint of the extension of American foreign trade, and from that of the prevention of financial disturbances.

Fourth.—The National Reserve Association will be the chief regulator of the country's currency expansion and contraction—certainly a public function in which everyone should be interested. At present the scant currency elasticity we have is derived principally from: (1) the importation, exportation, and coinage of gold; (2) receipts and disbursements of the independent treasury; and (3) a small expansion in the national bank note circulation which normally takes place in the late summer and fall. Under the proposed plan the tendency would be for the National Reserve Association to assume more and more the function of importing and exporting gold. Government receipts and disbursements would be effected chiefly through the Reserve Association, and the independent treasury would be virtually discontinued. The national bank notes would presumably all be withdrawn from circulation within a short time, and in their place ultimately would be sub-

stituted an elastic asset currency issued solely by the Reserve Association. This new bank note circulation would normally amount to upward of $900,000,000 (approximately 28 per cent of our entire monetary circulation), and by the payment of certain progressive taxes it might be expanded indefinitely. The new bank notes are to be receivable by the United States government in payment for all taxes and dues, to be legal tender in all payments to banks, and banks (holding stock in the association) are authorized to count their holdings of these notes as part of their legal reserves, thus making them a basis for further credit expansion.

The substitution of a centrally controlled and elastic bank note circulation for our defective bond-secured circulation is one of the most commendable features of the Aldrich plan. While the country's business is performed chiefly by means of deposit currency through the use of checks, there are certain needs which must be met by means of money (as contrasted with checks), and these needs are particularly important in a country so largely agricultural as the United States. At the crop-moving period of the fall, for example, and at the crop-planting period of the spring, a ready expansion of the monetary circulation is desirable, and if it is not forthcoming the money market becomes tightened, interest rates are pushed upward, and prices tend downward—to the discomfort of farmer, merchant, and banker alike. On the other hand, a ready and substantial contraction of the monetary circulation is needed after the holiday period and during the hot summer months; and if it does not take place, interest rates tend unduly downward, prices rise, and unhealthy speculation is stimulated—again to the discomfort of the conservative business community. For many years the country has suffered these alternations of chills and fever and should be grateful for a plan which promises to mitigate them.

Fifth.—A fifth public function of the National Reserve Association is to be found in the duties intrusted to it of supervising and regulating the conduct of banks. Local associations are to appoint examiners, who shall have authority to examine into the condition of the banks composing the association. Copies of the reports of these examination must be furnished the executive officers of the National Reserve Association and its branches upon request. This

supervision by an institution from which individual banks must from time to time seek accommodations should prove a strong ally to the comptroller of the currency, the state banking departments, and the clearing-houses in the work of toning up our banking business. In the course of time the Reserve Association will probably become the country's chief agency for the supervision and examination of banks.

One might specify many other public functions of the National Reserve Association, such as the fact that it will tend to become, like the Bank of England or the Reichsbank, a national clearing-house, and also the principal holder of the country's cash reserves; but enough has been said to show that the National Reserve Association will have large public powers and equally large public responsibilities.

If we turn now from the subject of the association's public powers and responsibilities to that of its control, the fact that stands out most prominently is that the National Reserve Association is controlled almost entirely by the banking community. All directors of local associations will be elected by bankers, and presumably will be bankers. Five-sixths of the directors of the branch associations will be bankers;[2] and all the directors of the branch associations, including the one-sixth which are "to fairly represent the industrial, commercial, agricultural, and other interests of the district," will be elected by bankers. Coming to the central association which will be the dominant body, we observe a control by the banking community, which is somewhat less complete than in the case of the local and branch associations, but still is very large. Fifteen of the forty-five directors of the National Reserve Association are to be elected, one each, by the boards of the fifteen branch associations; but these branch boards are all elected by bankers,[3] and five-sixths of the membership of each board consists of bankers. Twelve of the forty-five directors are to be elected by voting representatives of the various districts, each casting "a number of

[2] It is possible, but not very probable, that bankers will elect some persons as directors who do not belong to the banking fraternity.

[3] This statement is subject to the qualification that the manager of the branch association who is ex officio chairman of the branch board is to be appointed by the governor of the National Reserve Association with the approval of the executive committee.

votes equal to the number of shares in the National Reserve Association held by all the banks in the district which he represents." These twelve directors will accordingly also presumably be bankers, and their election will be controlled by bankers. The twenty-seven banker directors thus elected by bankers "shall in turn elect twelve additional members, who shall fairly represent the industrial, commercial, agricultural, and other interests of the country, and who shall not be officers of banks," but may be bank directors. This accounts for thirty-nine of the forty-five members of the board. Two more members, i.e., the two deputy governors, who in the original plan of Senator Aldrich were to be "selected by the president of the United States from a list submitted by the Board of Directors," are to be elected, according to the revised plan, by the Board of Directors. They are, moreover, removable only by the board. Here then is the selection of forty-one of the forty-five directors controlled absolutely by the banking community. Still another director, and the most important one, i.e., the governor of the association, is to be "selected by the president of the United States *from a list submitted by the Board of Directors*."[4] In Senator Aldrich's first plan the governor was subject to removal by the president of the United States for cause. This provision was criticized by the Currency Commission of the American Bankers' Association, and the revised plan makes the governor removable for cause only by a two-thirds vote of the Board of Directors. The other three members of the board, i.e., the secretary of the treasury, the secretary of commerce and labor, and the comptroller of the currency, are the only ones not chosen directly or indirectly by bankers. They represent but $6\frac{2}{3}$ per cent of the entire board, and this percentage will decline as the number of districts increases above fifteen.

These three government officials who are ex officio members of the board will probably exercise much influence, and this is particularly true of the comptroller of the currency, whose official duties as comptroller keep him well informed concerning banking affairs. Considerable power is doubtless guaranteed to these three ex officio members by the importance of their public positions, the publicity required of the National Reserve Association's affairs, and the facts

[4] Italics are mine.

that the comptroller of the currency will be a member of the Executive Committee, and that the secretary of the treasury will be ex officio chairman of the Board of Supervision.

Making due allowance for these facts, and also for the numerous restrictions both as to organization and function which the Aldrich plan imposes upon the association, should we not very seriously ask the question: *Is not the National Reserve Association too much of a public institution to be so largely controlled by one type of business interest, i.e., that of the banking fraternity?*

We must get away from the prevalent idea that the National Reserve Association is to be principally a bankers' affair just because its capital is to be furnished entirely by banks. We must bear in mind that its public deposits alone will for some time probably exceed its paid-up capital, that the funds which the banks deposit with the association will be chiefly those which the public has deposited with the banks, and that the paper which the banks rediscount with it will be that of the business community. We must not forget that the National Reserve Association is to have a tremendous public power and responsiblity, through its right to fix the bank rate of discount, its power over the foreign exchanges and gold shipments, its right to issue the country's only elastic paper currency, its supervisory power over banks, and its function of holding a large percentage of the country's reserve money, together with the privilege of having its promises to pay, in the form of its deposits and bank notes, counted as lawful reserve money for banks.

Now it is possible, although by no means certain, that the interests of bankers as a class and those of the public are identical. It is certain, however, that history furnishes numerous instances in which what the public believed to be its interest and what bankers believed to be theirs were in conflict. One need not go back farther than the last two or three years to find a striking instance of the kind in the United States. I refer to the movement leading to the establishment last year of the United States postal savings depositories, which was opposed vigorously and almost unanimously by the banking fraternity. It is furthermore true, and perhaps of greater importance, that a large element in the country believes the interests of bankers to be in conflict with those

of the general public on a great many vital questions. The task of securing and maintaining a thoroughgoing banking reform is at best an arduous one, and the definite plan which is finally placed before Congress and the public should be as far as possible above suspicion. Otherwise the project will have a difficult road in Congress, and if it finally gets through it will be in subsequent danger of becoming a football of politics.

If we turn for a moment to the great banks of Europe we find that although nominally and as regards stock-ownership they are private institutions, their officials have been forced more and more to feel the responsibilities of great public trusteeship. Moreover, in the leading European countries great care is taken to prevent the central banks from falling into the control of the banking class of the community or of any other special class. In Germany the ultimate control of the Reichsbank is in the imperial government, and is exercised by two boards, the Curatorium and the Directorium. The Curatorium is composed of five members. The imperial chancellor is chairman and he appoints one other member, while the Bundesrath (the upper house of the imperial legislature) appoints three members from its own numbers. The Directorium, consisting of nine members, two of whom are the president and vice-president of the Reichsbank, are all appointed by the emperor for life. In France the governor of the Bank of France and the two subgovernors are named by a decree of the president of the republic upon the proposal of the minister of finance; and the managers of the branches are named by decree of the president on the report of the minister of finance, upon the presentation made to him of three candidates by the governor of the bank. In England the government has no voice in the management of the Bank of England, the supreme control resting with the governor of the bank, the deputy governor, and twenty-four directors who are elected annually by the stockholders. No stockholder is permitted to vote unless he holds £500 of stock, but no matter how much additional stock he owns he can have not more than one vote. While "there is no legal restriction as to the class from which directors may be selected, except that they must be 'natural-born subjects of England, or naturalized,' . . . . in actual practice the selection

is confined to those who are, or have been, members of mercantile or financial houses, excluding bankers, brokers, bill discounters, or directors of other banks operating in the United Kingdom."[5]

One would hardly expect the *Wall Street Journal* to be prejudiced against the banking community, yet this journal said recently (October 17, 1911), referring to the recommendation of the Currency Committee of the American Bankers' Association that the choice of governor and deputy governors be intrusted to the Board of Directors of the Reserve Association instead of to the president of the United States—a recommendation which the revised Aldrich plan adopts so far as it relates to the selection of the two deputy governors:

> To adopt the plan of the Bankers' Association, to put the government of the Reserve Association wholly under the control of its shareholders and directors, would depart from the fundamental purpose of the project. This purpose is to establish a moderator in the money market equally interested in protecting the gold stock of the country, and the general financial situation, as well as the profits of its shareholders. In the European banks this obligation to the public is clearly recognized. The official appointed by the government occupies an unchallenged position as the representative of public interests in periods of crisis. It is an institution having this purpose in view which should be created in this country, and if the bankers expect to create one having a different purpose they are likely to shipwreck the entire project. . . . . Any plan which eliminates the interest of the government and the public in sound conditions will have a rocky road in Congress.

One simple method of increasing the non-banking public's participation in the control of the National Reserve Association is to give it a larger representation on the Board of Directors of the central association, and to make at least one of the deputy governors an appointee of the president of the United States. There is something anomalous in the provision of the Aldrich plan that the twelve directors who are to "fairly represent the industrial, commercial, agricultural, and other interests of the country" must be elected by twenty-seven banker directors, and that the three ex-officio government directors cannot even vote in the election of these twelve men who are to represent other than banking interests—all apparently on the ground that politics must be excluded from the association. With this object I am perfectly in sympathy, but

[5] "Interviews on the Banking and Currency Systems of England, Scotland, France, Germany, etc." (National Monetary Commission's Report), pp. 9–10.

with reference to the method of its attainment I am skeptical. Is not this a case of straining at a gnat and swallowing a camel? As a matter of fact, taking the public mind as it is today, is not one of the surest methods of bringing the National Reserve Association into politics and keeping it there the adoption of a plan to intrust its control so largely to the banking fraternity? Would not a provision for intrusting to the president of the United States the appointment of all or a substantial part of these twelve non-banking directors insure a broader and better qualified directorate for the performance of the association's important public functions? If these government directors were appointed for a six-year term of office, one-third of their number to retire every two years, would not the type of men usually appointed be such as to inspire public confidence in the Reserve Association, and to allay the popular prejudice so liable otherwise to arise and force the association into politics, i.e., the suspicion that the association is in the control of a small and selfishly interested class of the community?

The National Reserve Association, I believe, is the best plan that has yet been proposed for improving our defective banking system, and it is with much hesitation that I criticize it on any point. Personally I would much rather have it adopted in its present form, trusting to the future for amendments, than not to have it adopted at all. Senator Aldrich, however, has announced the plan as a tentative one and has invited criticisms. The present, I take it, is the time to criticize; soon the time will arrive for all friends of banking reform to lay aside minor differences and join in the fight for a banking system commensurate with the needs of a great country. It is not because of any prejudice or ill-will toward the banking fraternity—a business class for which I have the greatest respect—that I urge a larger element of non-banking control for the National Reserve Association; but rather because I believe that the infusion of such an element would strengthen the chance for the adoption of the plan, would protect the association, when once established, more effectively against the demagogue, and finally would help to make it in fact, as it is in function, *a great public trustee.*

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